LONDON STOCK EXCHANGE
An LSEG Business

THE FRESH PRINTS OF PS23/4

THE VIEW • EDITION 1

Welcome to the first edition of The View, a new quant research series from the London Stock Exchange. These pieces aim to provide insights into market microstructure topics, enable a deeper understanding of liquidity dynamics, and provide practical data to those responsible for investment decisions, trading strategies, and execution outcomes.

In this debut piece we will look at how the newly updated FCA post-trade transparency regime has changed the data you might be looking at. Overnight, 25% of total reported *volume* in FTSE 100 stocks disappeared. But has the *liquidity* of the UK market also changed? Here we will outline the rule changes that have come into effect and connect them to the changes observed in the data.

Summary

- Total market reported trading volumes have fallen by an average 25% for FTSE 100 constituents between 1 February 2024 and 31 July 2024, from all sources of trades.
- Addressable volumes have not changed.
- You should check if your tool is showing total or addressable volume and whether the definition is appropriate for your use case.
- OTC trade volumes fell by an average of 57% and now represent 24% of daily volume, down from 44%.
- The largest change has come from TNCP flagged trade volumes falling by an average of £4.4 billion per day.
- The new CLSE flag discloses trades executed at the closing price and now accounts for £280 million per day, on average.

What has changed in the rules?

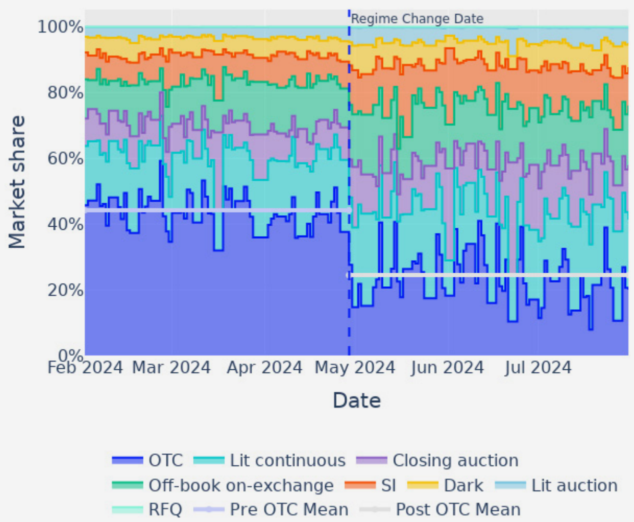
The post-trade transparency changes that went into effect on Monday, 29 April 2024 cover four main areas.

- Firstly, the FCA has added several new flags (CLSE, PORT, NTLS, NETW) and removed eight flags (ACTX, NLIQ, OILQ, PRIC, SIZE, ILQD, RPRI, DUPL).
- Secondly, the scope of transactions that are reportable has been narrowed for trades considered non-price forming, such as give ups and inter-company transfers.
- Thirdly, the new Designated Reporter Regime has come into effect, which allows investment firms to trade report without registering as a Systematic Internaliser (SI).
- Finally, the regulations ensure that trades are reported in major currencies.

What has changed in the data?

Figure 1 shows the share of trading by trade classification for FTSE 100 constituents from 1 February to 31 July, with the vertical dashed line marking the change in regime on Monday, 29 April. The largest change is that OTC transactions have fallen by an average of 57%, and thus their share of trading has fallen by approximately 20 percentage points, from 44% to 24%. As we shall explore in more detail below, this was expected given the regulatory change. The Lit continuous share of trading has risen by 4 percentage points, from 17% to 21%, largely due to the fall in OTC volumes, which we shall explore in more detail below.

Figure 1 – Share of trading by classification



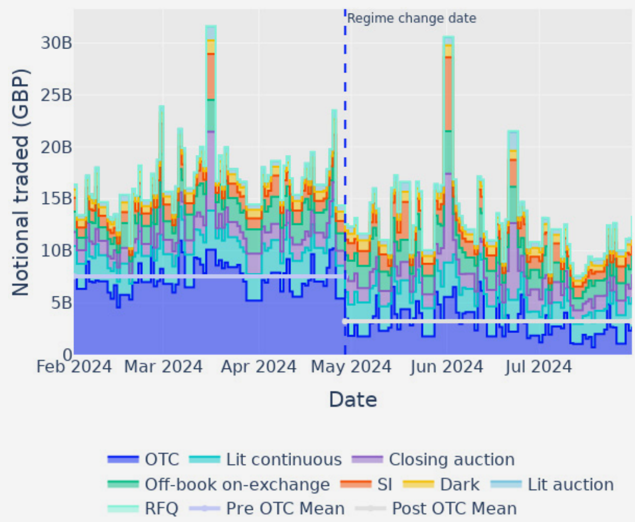
Source: BMLL Technologies

It is worth highlighting that there were several public holidays shortly after the change in regulation, with Labour Day in Europe on Wednesday 1 May and the UK bank holidays on 6 May and 27 May. As a result, there were days with depressed total volumes for reasons that were not connected to the regulation change. We have elected to exclude these dates, shifting their volume into the previous business day. This has the effect of increasing the average daily volume, and so represents a conservative choice.

Figure 2 provides a different perspective of the changes, displaying the traded notional by classification. The area corresponding to OTC declined by approximately £4.3 billion after the change - from a daily average of £7.5 billion prior to the change to £3.2 billion after.

Lit continuous experienced the second largest decline, decreasing by an average of £312 million per day, or 11% of its pre-change value. No other categories experienced a significant change in volume, with SI increasing by the most at £239 million per day, an increase of 17% of their pre-change daily value, in large part due to some exceptional trades, the largest of which was in LSEG stock totalling £3.1 billion on 15 May 2024.

Figure 2 – Notional traded by classification



Source: BMLL Technologies

There also notable volume spikes on 31 May 2024, when the MSCI indices rebalanced, and 21 June 2024, when the FTSE indices rebalanced, leading to an unusually large amount of activity in SIs and the closing auction.

Figure 2 has been compiled according to our own methodology, but it should align with the share of trading classifications from LSEG Workspace Market Share Reporter (MSR) or Bloomberg FRAG, or the views that include non-addressable liquidity from BMLL Vantage or big xyt. Please refer to the table in the appendix to see the precise definitions of each of the categories.

Although it has only been a short time since the regime changed, we expect this decline in OTC volumes to be a permanent structural shift and that the decline will be representative of the data that we will continue to see going forward, although the precise levels may fluctuate over time.

Where did the OTC volume go?

Since the regime change about £4.3 billion of OTC transactions are no longer showing up in the headline data. This leads to the question, where did they go?

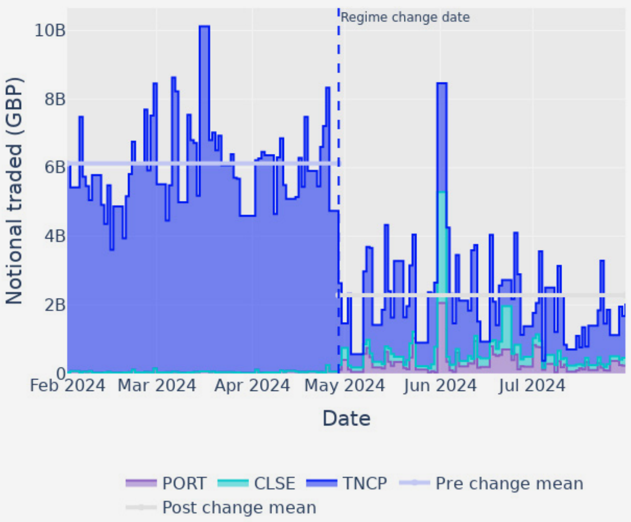
The new regulations have narrowed the scope of trades that need to be reported, thus reducing the notional that gets reported. The FCA confirmed that segregated discretionary funds were exempt. Give-up/-in trades done in the context of requests for market data and inter-affiliate trades are now also exempt. These types of transactions would have had a TNCP[1] flag (Transactions Not Contributing to the Price discovery process), and it is no surprise that the flag that has shown the sharpest decline is indeed TNCP. Such transactions get classified by BMLL and big xyt as contributing to their OTC groups, and the OTC NPFT/TNCP bucket in Workspace Market Share Reporter.

1 The full definition of a TNCP transaction is one “not contributing to the price discovery process, other than where covered by BENC, CLSE or PORT flags”. Where BENC transactions are transactions such as VWAP and TWAP, with a reference a price calculated over multiple time periods

In addition to the narrowing of the universe of reportable trades, the definition of the TNCP flag has also changed, with the introduction of two new flags that further narrow its definition, CLSE and PORT. CLSE transactions are those executed at the market closing price. A PORT flagged transaction has five or more instruments traded as a single lot against a reference price.

For the FTSE 100 index, there was a daily average of £6.1 billion in transactions flagged with TNCP before the regulation change. In the subsequent weeks this fell to a daily average of £1.7 billion, a decline of 73%. Figure 3 shows the total notional value reported with a TNCP, CLSE or PORT flag from 1 February to the 31 July for the constituents of the FTSE 100 index.

Figure 3 – Notional traded with TNCP, CLSE or PORT flags



Source: BMLL Technologies

The PORT flag has been available as an MMT flag since version 4.0, released on 1 January 2024, so a small volume of PORT flagged transactions occur prior to the change date. However, the volume increased after the change date, rising from a daily average of £45.9 million to £342.3 million. The CLSE flag is completely new, with all volume occurring after the change date. Transactions with this flag achieved a post-change average of approximately £280.2 million per day.

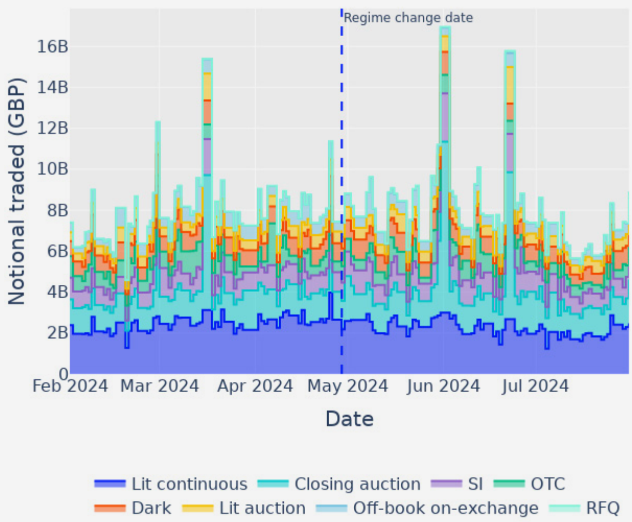
Addressing the addressable

Investors may have missed these changes if they are looking at addressable figures. This subset of the total trade volumes above attempts to filter out trades that are not relevant for traders.

Whilst there is not a settled definition of addressable that all can agree on, in broad strokes, it is volume that could have been interacted with by market participants and be part of the price formation process. As such, it is common to remove TNCP and NPFT (Non-Price Forming Trade), and others where it does not appear possible for market participants to interact with them. To place BENC and PORT on a similar footing to CLSE, we have elected to relax the TNCP constraint to allow TNCP trades that also share a BENC or PORT flag. We have outlined the set of filters that we feel are appropriate for this piece in the appendix, but this is just one opinion amongst many, and we believe it is best for the market and vendors to lead and provide choice for investors.

Figure 4 shows the addressable notional traded over the same period as Figures 1, 2 and 3. Using addressable liquidity results in no significant changes between the periods. Thus, investors can remain confident that the liquidity profile of the UK is unchanged, despite the headline total market volumes dropping. In this view, OTC volumes averaged £902 billion daily before the change, and £834 billion daily after. Overall volumes were unchanged at £7.9 billion daily.

Figure 4 – Addressable notional by classification



Source: BMLL Technologies

Traders and those with a secondary markets bias will most likely be interested in addressable market statistics. Some users, such as corporates, are more interested in the total activity in their stock and will find total market volumes of most interest. Some vendors provide options to extend the accessibility test to exclude trades conducted outside of regular market hours, as we have done, or even to exclude trades conducted under a Large In Scale waiver. These choices can change the proportion of trading classified as Lit Continuous to a range that varies from as much as 31% to as low as 17%.

All users should be mindful of which dataset they are looking at and how appropriate it is for their specific use case. Tools like Bloomberg FRAG and Workspace MSR show total market volumes – is that what you want?

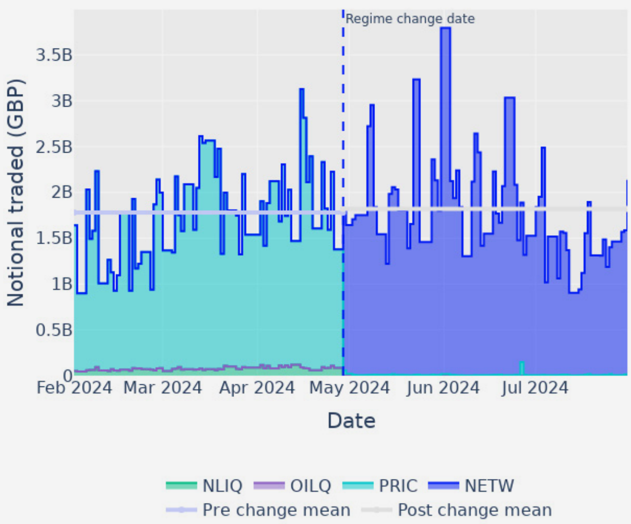
Half-mast for deleted flags

The reporting requirements of SIs were simplified by the new post-trade transparency regime. Prior to the change, there were three flags SIZE, ILQD, and RPRI that only applied to trades executed on an SI. SIZE is used to indicate an order that is executed above the standard market size, ILQD identifies illiquid instruments, and RPRI identifies trades that receive price improvement. The FCA argued that these flags did not reflect relevant information, and so could be safely deleted. For example, the BMLL taxonomy does not split by these flags so removing these tags does not show as a change in any of their SI buckets.

The negotiated trade flags have also changed, with the three flags NLIQ, OILQ, and PRIC being replaced with just one flag, NETW. NLIQ identified transactions in a liquid equity that are executed within the spread, QILQ identified transactions in illiquid equities, and PRIC identified transactions subject to conditions other than the current market price.

In contrast NETW simply identifies transactions executed under the negotiated trade waiver. Figure 5 shows the effect of the reclassification, with pre-change average volume for NLIQ, OILQ or PRIC flagged trades of £1.8 billion against a post change NETW daily average of also £1.8 billion.

Figure 5 – NETW vs NLIQ, OILQ and PRIC



Source: BMLL Technologies

In the pre-change period, 69% of PRIC flagged trades also had an NPFT flag, indicating that the trade was agreed subject to conditions other than the current market price and are not price forming. Post change, the proportion of NETW volume that was also NPFT rose slightly to 73%.

The other two flags that have been deleted are the agency cross flag ACTX, and the duplicate trade DUPL. The FCA found that the DUPL flag is not currently used in the UK and that it was not clear how the ACTX flag was being used and if it provided meaningful information.

Designated reporter regime – one to watch

The introduction of the Designated Reporter (DR) regime should help reduce the administrative burden related to requiring a SI to be responsible for reporting. Although not immediately relevant to the trade data currently observed, this change may have a longer term impact on where trades are reported.

Previously, an investment firm that wanted to assume trade reporting responsibilities from its counterparties would have had to be registered as a SI, and thus incur the regulatory responsibility that comes with that status. The new regime simplifies this by separating the reporting obligation from the SI definition, allowing firms to register just as a DR, gaining the responsibility to report all trades with fewer regulatory burdens. The FCA anticipates that this will allow smaller sell-side firms to compete with SIs.

Furthermore, DR status grants the obligation to trade report at the entity level, whereas previously this obligation was established at an instrument level. Lifting the obligation to the entity level should simplify the relationships between buy-side and sell-side firms by removing the requirement to check if the reporting status of an instrument has already been agreed.

In terms of the trade classification data, separating the DR status from the SI status may also result in a pause in the trend of increased share of trading being done through SIs, as investment firms that would previously have registered as an SI instead elect to register as a DR.

To place this in context, there are currently 73 firms registered with the FCA as a DR or Designated Reporter Branch (DRB) and 25 SIs registered to trade shares. At the beginning of the year there were 27 SIs, and in October 2023 there were 30 (FCA, 2024). Although there has been a drop in the number of registered SIs, there has not been a corresponding change in SI market share. However, this may be a long-term structural change that will be interesting to monitor going forward.

Conclusion

The new post-trade transparency regime that went into effect on Monday 29 April 2024 was designed to improve data quality, reduce noise, and lower regulatory burdens. As a result, aggregated trade data sources have shown material changes when looking at total market data, but the amount of addressable volume has not changed and so the liquidity profile of UK stocks should also be unchanged. Investors who are reviewing the size of the UK market would, however, be wise to check which definitions their tools are using and if they are suitable.

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APPENDIX

Table of changes

Change	Summary
TNCP flag changed	Transactions not contributing to the price discovery process, other than where covered by BENC, CLSE or PORT flags.
CLSE flag added	Benchmark transactions executed at the market closing price.
PORT flag added	Transactions in five or more different financial instruments where those transactions are traded at the same time by the same client and as a single lot against a specific reference price.
NTLS flag added	Transactions that are large in scale compared with normal market size for which pre-trade transparency can be waived.
NETW flag added	Negotiated transaction flag.
ACTX flag deleted	Agency cross transactions flag, where an investment firm has brought together clients' orders with the purchase and the sale conducted as one transaction and involving the same volume and price.
NLIQ flag deleted	Negotiated transaction in liquid financial instruments flag.
OILQ flag deleted	Negotiated transaction in illiquid financial instruments flag.
PRIC flag deleted	Negotiated transaction subject to conditions other than the current market price flag.
SIZE flag deleted	Transactions executed on a systematic internaliser where the size of the incoming order was above the standard market.
ILQD flag deleted	Transactions in illiquid instruments executed on a systematic internaliser.
RPRI flag deleted	Transactions executed on a systematic internaliser which have received price improvement flag.
DUPL flag deleted	Duplicative trade reports flag, when a transaction is reported to more than one APA.
Introduction of Designated Reporter Regime	Decoupling of SI status and obligation to ensure a trade is made public.
Scope of reportable transactions narrowed	The scope of non-price forming transactions such as inter-funds transfers, give-ups and give-ins, and inter-affiliate trades has been narrowed.

Source: FCA PS23/4

Classification Matrix

Classifications	Rule
Lit Continuous	MarketMechanism IN (1 (Central Limit Order Book), 7 (Any Other)) & TradingMode == 2 (Continuous Trading) & TransactionCategory != D (Dark Trade)
Lit Closing Auction	TradingMode == K (Closing Auction) & TransactionCategory != D (Dark Trade)
Lit Auction	(TradingMode IN (1 (Undefined Auction), O (Opening Auction), I (Intraday Auction), U (Unscheduled Auction), P (On Demand Auction)) & TransactionCategory != D (Dark Trade)) OR (ExecutionVenue == 'BATE' & MarketMechanism == 5 (Periodic Auction) & TradingMode == 4 (Out of Main Session Trading))
Dark	MarketMechanism == 3 (Dark Book) OR TransactionCategory == D (Dark Trade) OR ExecutionVenue IN ('LISX', 'LISZ')
Off-Book On-Exchange	MarketMechanism == 4 (Off Book) & TradingMode == 5 (On Exchange) & ExecutionVenue NOT IN ('LISX', 'LISZ')
SI	ExecutionVenue == 'SINT'
RFQ	MarketMechanism == 6 (Request for Quotes) & TradingMode == 2 (Continuous Trading)
OTC	All otherwise unclassified

Addressability Requirements	Rule
Within Regular Hours	TradeTimestamp BETWEEN 08:00 – 16:40 London
Standard Currency	CurrencyCode IN ('GBp', 'GBP')
Not NPFT	PriceFormation != T
Not TNCP except BENC or PORT	(PriceFormation != J OR BenchmarkIndicator IN (B, P, Y, M, N, O, 2, 4))
Not CONT	BenchmarkIndicator NOT IN (C, M, N, O, 3, 4)
Not DUPL or XBDT or IGRP	DuplicativeIndicator NOT IN (1, 2, 3, 4, 5, 6, 7)
Not SDIV	SpecialDividendIndicator != E
Not GIVE	TransactionCategory NOT IN (G, H)

The definitions we have provided should not be considered an authoritative definition that will be appropriate for all users. We provide them for illustrative purposes only.